Financial Performance

TVA is financially sound today and is taking action to ensure that it remains competitive as the electric power industry is restructured. TVA's financial performance reflects its goals of enhancing the quality of life in the Tennessee Valley by providing reliable, affordable electric power, by providing environmental stewardship and integrated management of the Tennessee River system, and by promoting sustainable economic development throughout the Tennessee Valley.

TVA uses capital efficiently to maintain financial health and predicates its decisions on where and when to invest capital on how it can best meet the needs of the Tennessee Valley. Over the last few years, TVA has been able to reduce long-term debt, add new generation and transmission capacity and invest in new environmental technologies while keeping power rates steady.

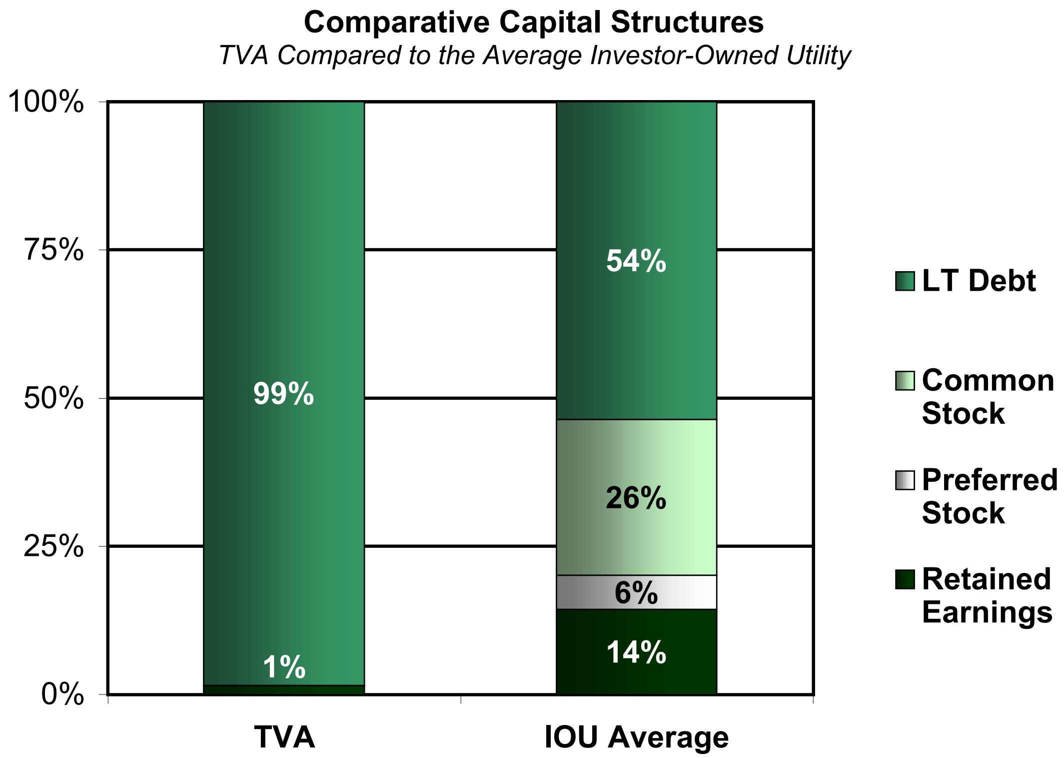
In 2001…

- Cash flow from operations increased by over $300 million.
- Generating capacity increased by almost 900 megawatts.
- Debt reduced by $610 million, bringing cumulative debt reduction to $2.35 billion since the beginning of 1997.
- Annual net interest expense decreased by $103 million.

Measuring Financial Health

One method of measuring the financial health of a company is to analyze financial statements using common financial metrics. The optimum value for any metric, however, is different across industries and for different companies within the same industry. What would be considered an adequate interest coverage ratio for a consumer retail business, for example, would be very different from that considered adequate for an electric utility. Comparing the ratios of two companies in different industries or companies that are greatly different in size would not be meaningful. TVA's financial health, like that of other public power entities, must be measured in the context of its operating purpose. TVA was created to generate prosperity for the people it serves, rather than to create wealth for shareholders.

While TVA uses about the same amount of total capital as other utilities, it has more limited means of obtaining these dollars. Since it is not authorized to issue stock, TVA raises the capital it needs primarily by issuing debt, resulting in a capital structure very different from that of an investor-owned utility. A typical investor-owned utility raises capital through a mixture of common stock, preferred stock, short-term and long-term debt, and tax deferrals and by maximizing profit for reinvestment.



Source: EEI 2000 Financial Review Plus Preview of 2001, TVA 2001 Annual Report

TVA's Financial Health

TVA is financially healthy today, as demonstrated by continued strong financial performance. But because of TVA's unique capital structure, some standard measures of financial health are not useful in assessing TVA's financial performance (e.g., debt to equity).

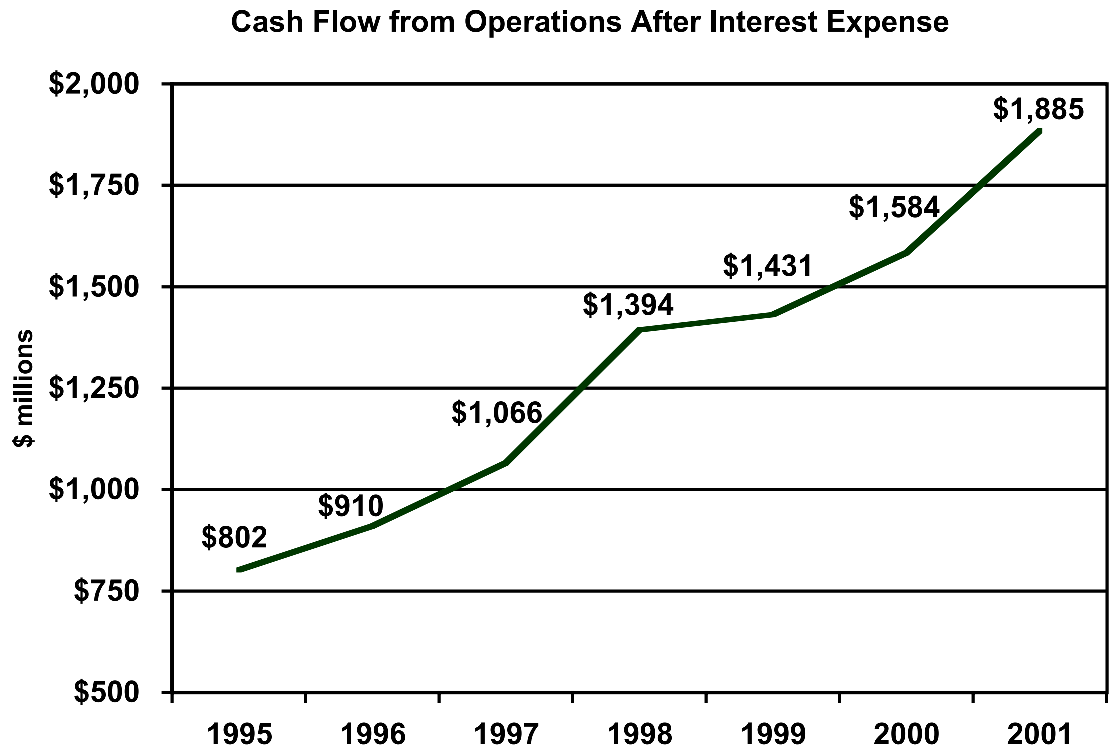
The most obvious measure of financial health for any company, and one that is useful in assessing TVA's financial performance, is whether the company can pay all of its bills, which includes servicing its debt and other capital obligations. The amount of cash that a company generates is therefore an important measurement of financial health.

Some other measures of financial health that are useful in evaluating TVA are measures of TVA's debt burden that illustrate the effectiveness with which TVA leverages debt. These measures include TVA's debt per kilowatt of generating capacity, a comparison of TVA's market value capitalization to that of its competitors, TVA's interest expense as a percentage of sales, and a comparison of TVA's operating costs and the delivered cost of power with other utilities.

Together, all of these measures help provide a more meaningful assessment of TVA's financial health.

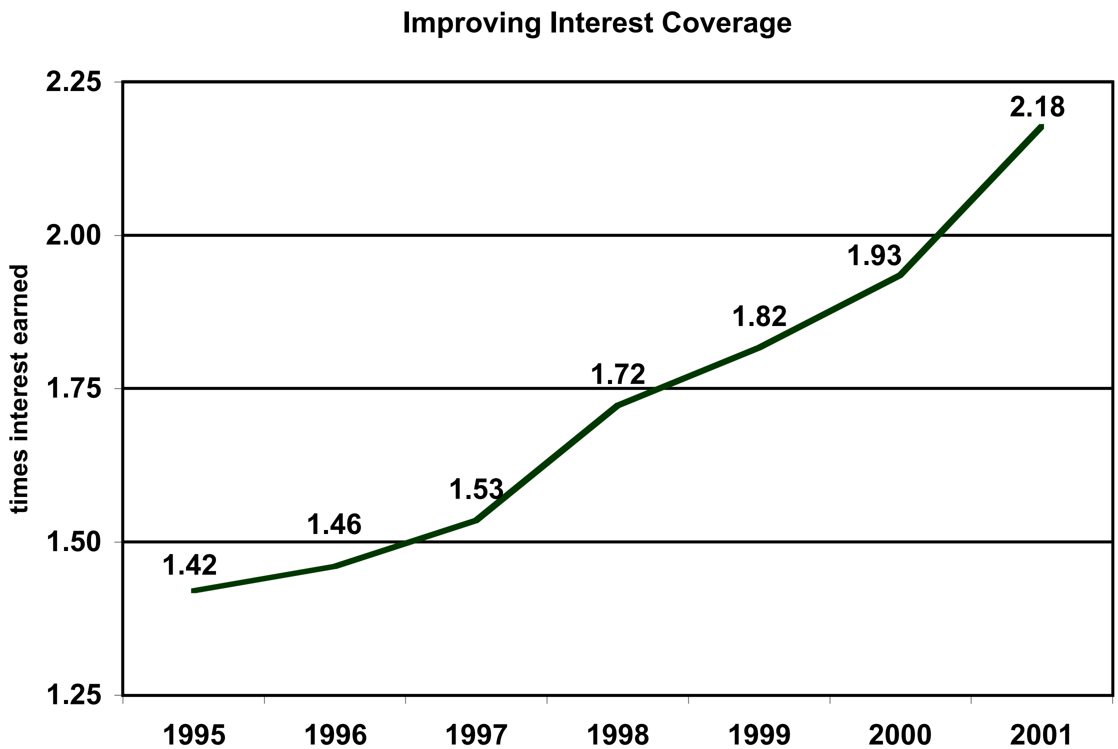
Cash Flow

TVA generated revenue of almost $7 billion in 2001, an increase of 3.5% over the prior year. As revenue increased, cash flow from operations also increased. In fact, cash flow from operations before interest expense was almost $3.5 billion. Even after subtracting interest expense, TVA's cash flow from operations has improved by 135% since 1995, to $1.9 billion - up from $800 million.



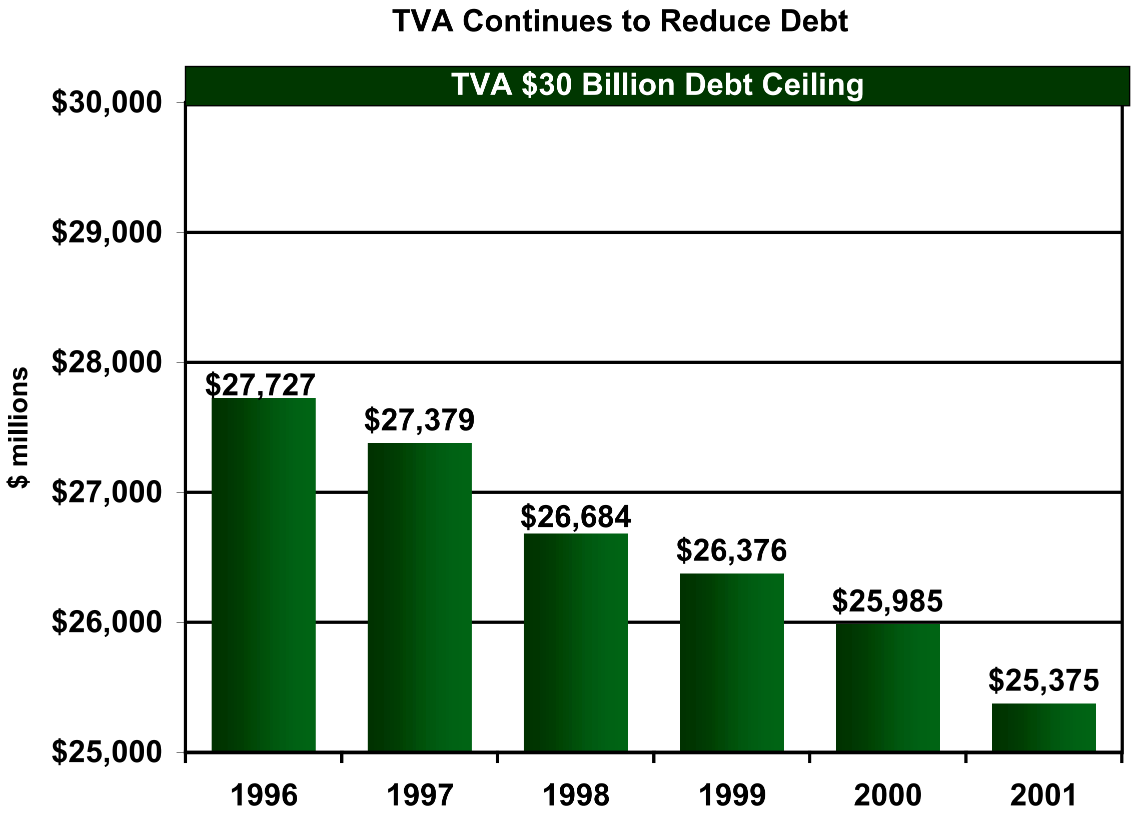
Interest Coverage

TVA has made dramatic improvement to its interest coverage ratio, increasing it to 2.18 times coverage - an improvement of 54% since 1995. Unlike TVA, investor-owned utilities can obtain a portion of the capital they use from issuing stock. For them, the cost to service this equity must be covered from cash flows from operations after interest expense, so their coverage ratios are, understandably, larger than TVA's.



Debt Leverage

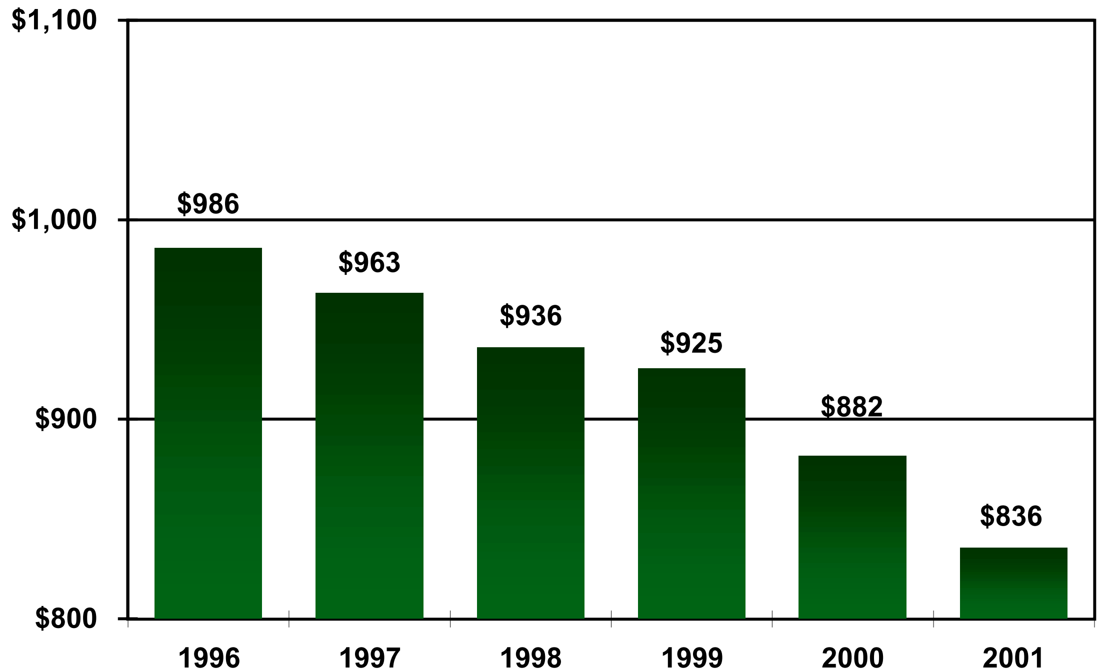
As cash flow has increased, TVA has been able to reduce its debt. TVA reduced total debt from its peak of $27.7 billion to $25.4 billion by the end of 2001, a $2.3 billion decrease.



But more importantly than simply reducing the level of debt, TVA has ensured that it continues to use capital as efficiently as possible.

TVA's efficiency in using its debt can be measured by comparing its total debt outstanding with its generating capacity. This debt *burden* has improved by 15% since 1996 — decreasing from $986 per kilowatt of capacity to $836. TVA will continue to improve the efficiency of its capital while balancing the long-term goals of continuing the trend of debt reduction with meeting the long-term needs of the Tennessee Valley.

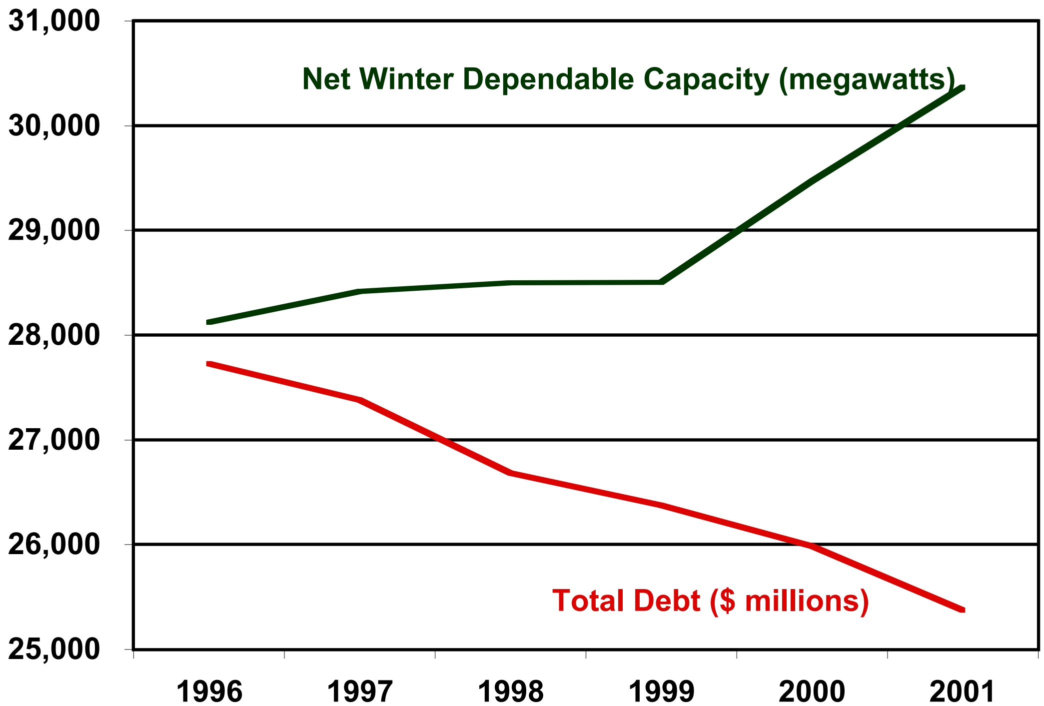
Total Debt per Kilowatt of Capacity



Debt Leverage (continued)

TVA has also reduced the *burden* of its debt. TVA primarily uses its debt to finance its power and transmission systems. Yet, TVA reduced debt by $610 million in 2001, while net winter dependable capacity increased by almost 900 megawatts.

Debt Decreases While Capacity Increases



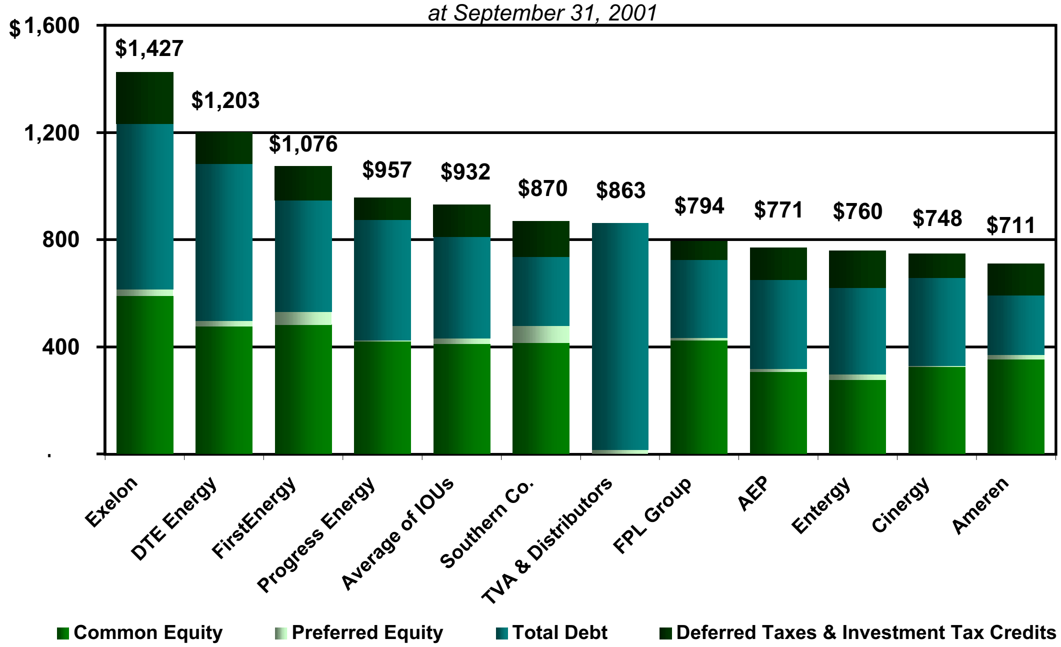
Market Value Capitalization

TVA's debt per kilowatt of capacity may seem high compared to the same ratio for an investor-owned utility. However, TVA uses about the same amount of total capital to finance its power system as these other utilities – it is just different in form.

Investor-owned utilities fund their operations in some ways that are not available to TVA, such as through the issuance of common stock, the issuance of preferred stock, various forms of short-term and long-term debt not available to TVA (e.g., mortgage financing, subsidized loans such as pollution control bonds, etc.), and tax deferrals and by maximizing profit for reinvestment.

When these sources of capital are considered along with debt, the total capitalization of TVA and the distributors of TVA power is comparable to the total capitalization of the average investor-owned utility.

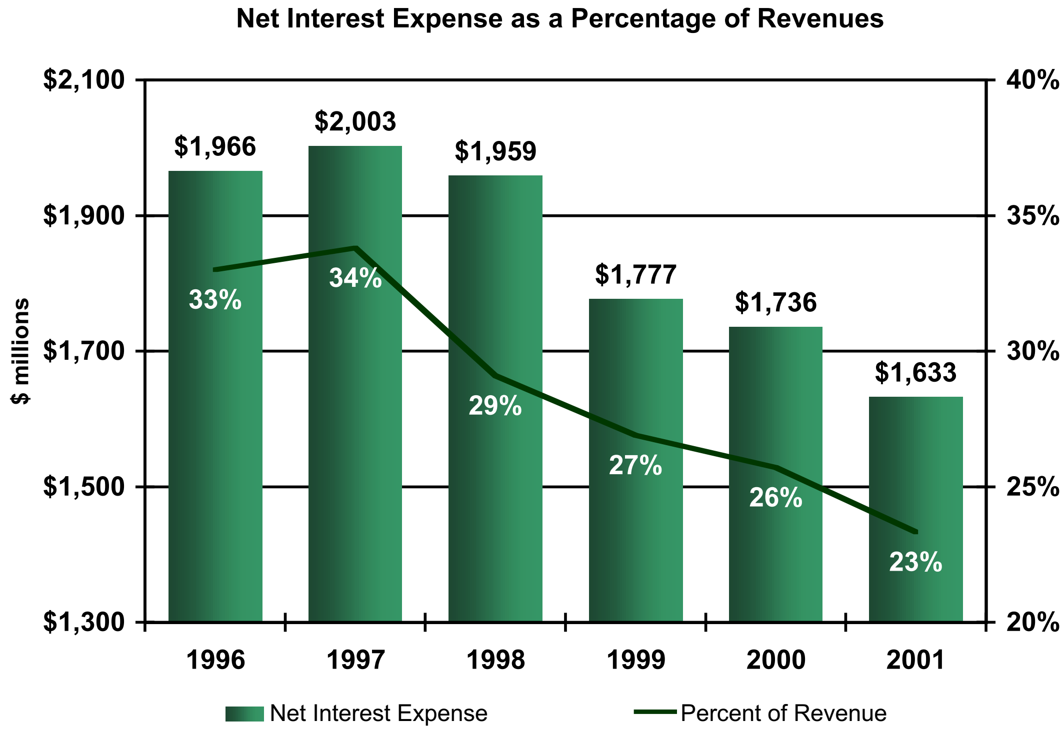
Market Value Capitalization Per Kilowatt of Installed Nameplate Capacity
at September 31, 2001



Note: Common equity value calculated as number of outstanding common shares times stock price as of September 30, 2001. Other capital items recorded at book value.
Sources: TVA 2001 Annual Report; 2001 Distributors of TVA Power - Summary of Financial Statements, Sales Statistics and Rates; Company 3rd Quarter 10-Q Filings & 2000 Annual Reports, Bloomberg

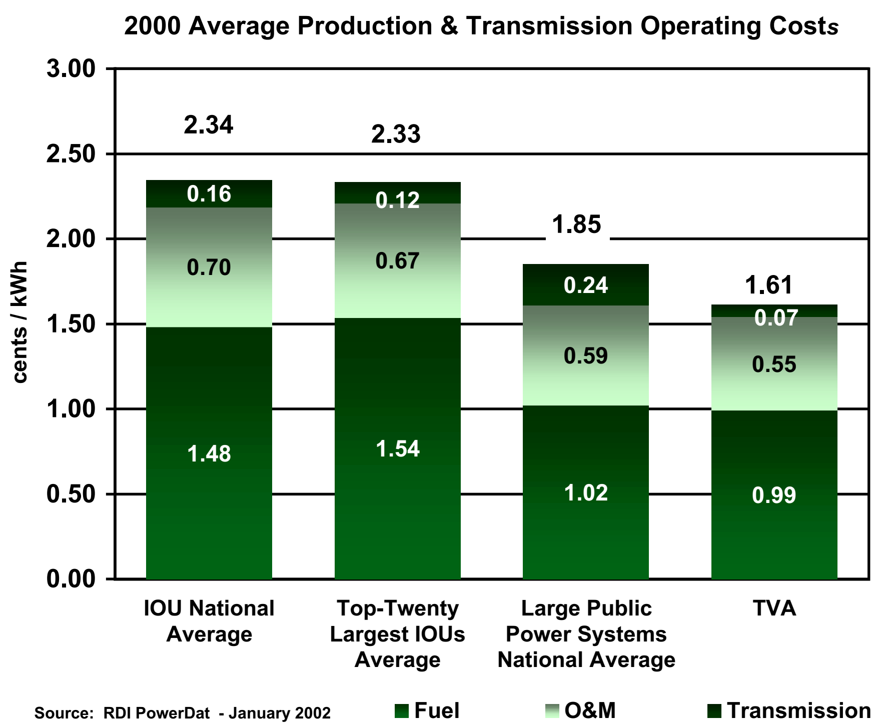
Interest as a Percentage of Revenues

The annual amount that TVA incurs for interest is down $370 million from its high point. TVA's net interest expense compared to total annual revenue, which is another indication of how TVA leverages its debt, is lower than any time in the past 15 years. The reasons for this improvement are an increase in power sales coupled with prudent management of TVA's debt portfolio. Since 1997, net interest expense as a percentage of revenues has decreased by a third.



Cost Comparison

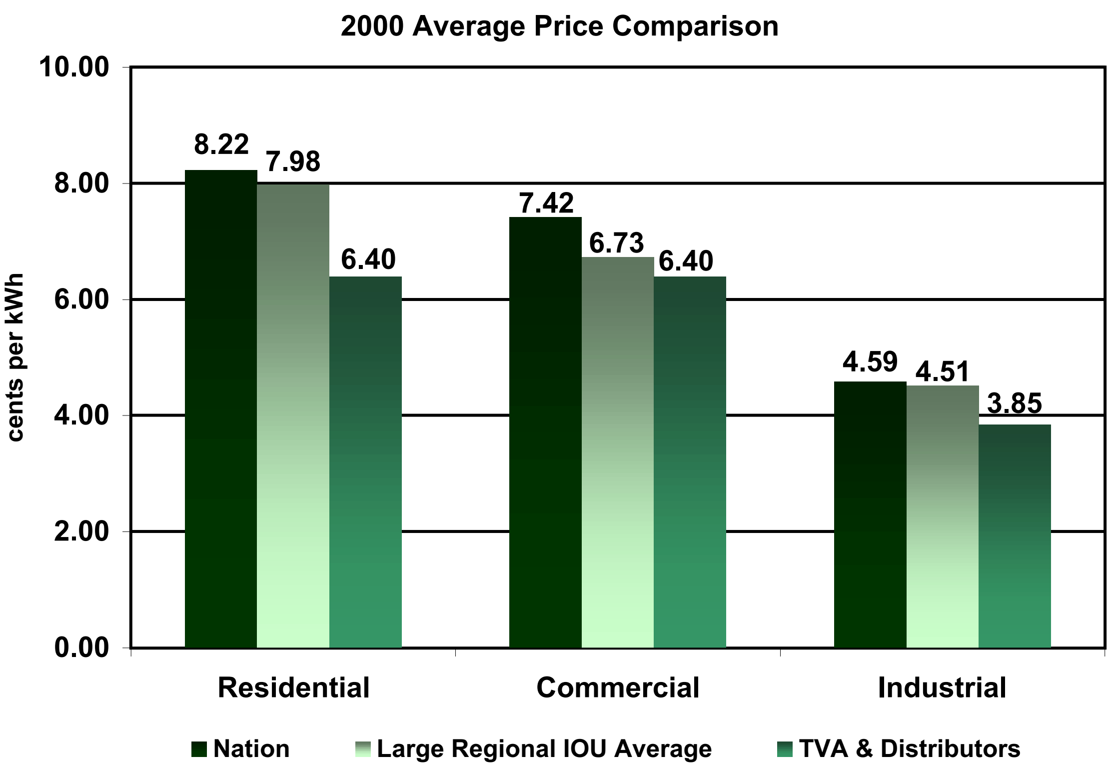
TVA has been competitive in the past and remains competitive today, in part because of its low operating costs. Operating costs are all the costs that are incurred in the production and distribution of electricity, such as fuel, operation and maintenance expenses, and transmission expense. TVA's operating costs compare favorably to those of utilities throughout the nation.



Reducing the Delivered Cost of Power

One of TVA's six strategic objectives is to reduce the delivered cost of power relative to the market. TVA has been able to accomplish this objective partially through prudent debt portfolio management. Prudent management, coupled with TVA's low production costs, equates to low prices for electricity consumers in the Tennessee Valley region.

The average residential power price in the area served by TVA is 6.40 cents per kilowatt-hour, 22% below the national average. The average residential price in areas served by the twelve investor-owned utilities in the eastern interconnecting grid that generate 50 million megawatt-hours or more annually is almost 8 cents per kilowatt-hour. Additionally, commercial and industrial prices in the area served by TVA are 14% and 16% below the national average, respectively.



Source: RDI PowerDat - January 2002

Preparing for the Future

TVA is focused on preparing for the future. TVA is improving its financial flexibility and is taking action to position itself strategically in a competitive environment. Two specific ways TVA is preparing for competition are by using lease financing to provide flexibility in meeting power needs and by adjusting the value of certain assets.

Lease Financing

In 2000, TVA financed eight combustion turbines using lease-leaseback transactions and in November 2001, TVA used a similar transaction to finance eight additional combustion turbine units. Under this form of financing, TVA leases the generating units to a private investor for more than the useful lives of the units, then leases the units back under a 20-year lease agreement.

This common method of financing provides TVA with operational and financial flexibility in meeting the future power needs of the Tennessee Valley. Because it is difficult to predict future demand, the lease arrangements provide TVA with a source of additional power generation, but shift to a private investor the risk that the generating units will be obsolete at the end of the leaseback term. Additionally, TVA negotiated options for early termination of the lease arrangements during the 20-year period, as well as the option to purchase the units at the end of the lease.

This kind of operating flexibility, along with the favorable financing rate obtained, helps TVA keep costs low in the future and maintain low power prices for its customers.

These lease financing obligations are recorded on TVA's balance sheet as a liability and the periodic lease payments are recorded as an operating expense. TVA fully disclosed these transactions, consistent with normal business practices and in accordance with generally accepted accounting principles.

Asset Valuation

In 2001, TVA determined that the book values of some existing assets would not be appropriate in a competitive marketplace. It was estimated that the amount of cash that these assets would provide through future rates was likely to be less than their recorded book values. Accordingly, TVA reduced the carrying amount of these assets by $3.4 billion and recognized an impairment loss in 2001, in accordance with generally accepted accounting principles.

While this adjustment resulted in a non-recurring loss, it had no impact on TVA's current financial condition or future financial stability. There was no impact on cash flow and no impact on TVA's credit rating, and the adjustment does not preclude TVA from using these assets in the future.

TVA has made periodic reviews and assessments of its assets in the past and, as appropriate, has made similar asset valuation adjustments. The asset valuation adjustments made in 2001 will provide a more conservative reflection of TVA's asset values on its financial statements and will help TVA maintain competitive prices in the competitive marketplace of the future.

Future Financial Health

TVA's goal is to continue to be the provider of choice for its customers as the industry becomes more competitive. TVA is taking steps to ensure that it remains financially healthy while continuing to offer affordable, reliable power. TVA will continue to weigh the future needs of the Tennessee Valley while continuing its trend of reducing debt and, ultimately, reducing its delivered cost of power relative to the market.